A new breed

Continued from page 13

Springer said. "You're involved every hour of every day. There's a broad base of people to supervise. You have to keep abreast of what's going on inside and outside the business, you've got to keep in front of the pack."

Today the chief financial officer has to wear a number of hats. The CFO must help analyze mergers and acquisitions, be adept at finding creative and cost-efficient ways of raising money in capital markets worldwide, manage foreign exchange exposure, oversee the investment of huge pension funds and corporate cash, fashion tax strategies, constantly monitor and measure corporate asset performance, spot poor performing assets and dispose of them, and much more.

The financial officer also has to track interest rates and currency fluctuations, keep up with international trade issues and global stock market developments, spot windows for financing throughout the world, master an array of financial instruments, and be able to assess the financial implications of business decisions. To juggle all these diverse duties, agility is a plus.

"There are a whole myriad of products coming off the street that they have to be up to speed on," said Ted Jadick, partner with Heidrick & Struggles Inc., New York, an executive recruitment firm.

Job qualifications — both academic credentials and practical experience — have increased as the work of the chief financial officer has become more complex, he said.

"Now you're finding that the stronger CFOs have undergraduate degrees, MBAs and they come up through the treasury side where they are interfacing with the financial community," Mr. Jadick said. In the past, chief financial officers came to the job with an undergraduate degree in accounting and a background on the control side of the business.

Among the biggest challenges those interviewed cited is the array of financial instruments that can be tapped when companies need to raise money.

"The CFO always had to provide financing sources for the company. But it used to be you'd go to your investment banker and get a 25-year bond," Avon's Mr. Zimmerman said. "All the borrowing was the same plain-vanilla, fixed-rate type. Now the nature of the financial products out there requires expertise in currency and interest rate swaps and many other areas."

Others, however, contend the technical demands on chief financial officers can be overstated.

"I find that most CFOs I've dealt with don't tend to get too technically involved," said David Blair, president of Bushell Blair & Associates, a New York-based executive search firm. "I've heard so many managers at the $100,000 level-plus say, 'At my level, you understand, I don't need to know these things.' "

Maria Monet, chief financial officer at Ogden Corp., New York, and president of Ogden Financial Services, spends a good deal of her time developing innovative financing vehicles for Ogden resource recovery plants and other Ogden subsidiaries.

All the financial officers interviewed said hiring the best and the brightest staffs they can find goes a long way toward making their jobs easier.

D.W. Russler, senior vice president-finance and administration, and chief financial officer, NCR Corp., Dayton, Ohio, said the competition for the best and the brightest is getting tougher. "It's a very competitive environment. The competition from companies, big eight accounting firms, and U.S. industry is fierce," he said.

"No CFO is totally qualified to do it all," Avon's Mr. Zimmerman said. "You get the best people." ■

Brad Rudin contributed to this story.

Kemper retires some old ideas about 401(k)s.

"They're a nightmare to administer."
Not our 401(k)s. Kemper handles all the details, from helping to design a plan that meets your needs to presenting it to your employees to record keeping and reporting.

"They lock you into one or two investments."
Many plans do. But a Kemper 401(k) offers a whole family of mutual funds and annuity products managed by Kemper Financial Services, Inc. Your employees can choose their own investment course ranging from aggressive growth funds to U.S. government security and money market funds.

"They're expensive."
We can show how the implementation of a 401(k) plan need not be a costly employee benefit for your company. For a look, a free video cassette, and prospectuses containing more complete information, including management fees and expenses, call us today. Please read the prospectuses carefully before investing or sending money.

Call us toll-free at:
1-800-356-1010, Ext. 1442

Kemper. There's never a bad time to make a good investment.℠

Kemper Financial

Kemper Financial Services, Inc., Chicago, IL

Suit filed over loss in crash

KANSAS CITY, Mo. — Utilicorp United Inc. is seeking $11.8 million in damages from Kemper Financial Services Inc., Chicago, claiming the money manager did not liquidate a stock portfolio prior to the October crash as instructed.

The suit states Kemper, which managed approximately $20 million in a separate account for a Utilicorp pension fund, was instructed to liquidate $8 million Oct. 14 and to transfer the cash Oct. 21 to The United Missouri Bank of Kansas City, Utilicorp's master trustee.

The suit states Kemper failed to follow through and the trustee received only $2 million Oct. 21. The suit states Kemper delayed the process, liquidating $2 million Oct. 20, $3 million Oct. 21 and $3 million Oct. 22.

According to the lawsuit, Kemper later misrepresented the dates on which the liquidation took place.

Utilicorp's employee benefit assets total approximately $45 million and consist of seven defined benefit plans.

The suit asks for actual damages of $1.8 million — the amount the utility claims it lost by the delay — and $10 million in punitive damages.

Kemper officials denied the mishandling, saying they were not given instructions regarding the redemption until the day the market crashed.

Charles Kierscht, president of Kemper, said the utility "did tell us Oct. 14 that $8 million would be moving to another manager and that the other manager would contact us regarding the transfer.

"The new manager didn't contact us until the close of business Oct. 19 and said he would take cash" instead of securities, Mr. Kierscht said. "We liquidated over the next three days, and I can't understand why the lawsuit was filed."

Bank officials and the bank's attorney would not comment on the lawsuit.

Steve Cochennet, senior manager-administration at Utilicorp, referred questions to the company's attorney, William H. Sanders, who is a partner with the Kansas City law firm of Blackwell, Sanders, Matheny, Weary & Lombardi.

"They were told to sell," Mr. Sanders said. "It's not up to the manager to tell them.

"They were told to sell by Utilicorp, and they agreed to sell, and the new manager did call and left his name that day," he said.

United Missouri Bank filed the suit on behalf of the company in U.S. District Court in Kansas City. ■

FINANCING

Debt-for-stock swap pulls Savin to safety

Bankruptcy threat dissolves with offer

By Brad Rudin

STAMFORD, Conn. — Savin Corp. stepped back from the brink of bankruptcy late last month after creditors agreed to a revised exchange offer in which debt will be swapped for convertible preferred stock.

With the exchange offer almost in place, Savin can look forward to a healthier balance sheet and the prospect of an alliance with an innovative business partner.

The copier distributor's earlier offer to swap debt and preferred stock for common stock ran into resistance from creditors, who balked at the prospect of turning in their bonds for a junior security.

"Some people criticized us for initially printing an offer that basically said that all debt has to go to common stock," said Ralph O. Hellmold, managing director and head of the workout group at Prudential-Bache Capital Funding, New York, which serves as Savin's financial adviser. "I learned a long time ago that if you don't ask for something aggressive you have no hope of ending up with something realistic."

Because the exchange offer calls upon Polysar Energy & Chemical Corp., Toronto, a major Savin shareholder, to swap notes totaling $77.1 million for preferred stock, the deal prevents the bankruptcy petition that would have followed if Polysar demanded for payment on the notes. Polysar's agreement to swap its debt for preferred stock is contingent on an 85% exchange of increasing-rate notes for preferred stock.

"Two years ago the company lost . . . $36 million to $40 million from operations and the share price was about 7. A year ago we lost $9.2 million from operations and share price was 3 or 3¼. Now we finally show a profit for the first time in seven years and my shares are selling for a quarter. Give me a break."

— David G. Sadler
Chairman and CEO

The exchange offer, formulated with the help of Prudential-Bache, follows by two years an offer completed under the guidance of another financial adviser. In that offer, Savin replaced long-term debt with shorter-term obligations.

Because the zero-coupon bonds created in the earlier exchange could be converted into common stock and because interest on other debt could be paid in common stock, the number of outstanding shares increased to 60

Continued on page 32

Activity returns with new strength

By Brad Rudin

NEW YORK — Breaking out of its long-held position in the middle of the bulge bracket, Merrill Lynch Capital Markets Inc. grabbed the biggest share of the first quarter's expanding underwriting business.

Total domestic volume rose to $67.9 billion in the first quarter, up 58% from the $43.1 billion level reached in the last quarter of 1987, according to IDD Information Services Inc., New York. Still, underwriting volume is much lower than the $89.5 billion figure recorded in the first quarter of last year.

The generally improving stock market encouraged a 34% increase in common stock underwritings to $7.7 billion in the first quarter from $5.8 billion in the fourth quarter of 1987. The volume of initial public offerings tripled to $7.1 billion in the first quarter of 1988 from $2.4 billion the previous quarter, according to IDD data.

A bond market rally in the first half of the first quarter fueled debt underwriting activity. The rally gave issuers "the most attractive financing opportunities in medium- and long-term maturities in two years," according to the Feb. 12 issue of Comments on Credit, a Salomon Brothers Inc. publication.

Industrial issuers have been encouraged to tap the debt market because of the positive economic news released during the first quarter, said Peter Skaperdas, a vice president in Salomon's fixed-income research unit.

Although the bond market fizzled in the middle of the first quarter, the financing environment for issuers remained relatively favorable because spreads against Treasuries remained tight, Mr. Skaperdas said. "We still think it's a favorable environment for issuers."

The expanding volume of public offerings accompanied a wider sharing of underwriting business. The top five firms did 65% of the domestic underwriting business in the first quarter compared with 70% in the fourth quarter of 1987.

Displacing Salomon, the traditional leader in the underwriting league tables, Merrill Lynch took 17.2% of all first-quarter domestic underwriting business. Salomon, which finished the quarter in second place, did 14.3% of the business. Third-place Goldman, Sachs & Co. took a

Continued on page 33

1st quarter underwriting rankings (Full credit to lead manager)

All issues - global*

Firm	Volume $ mils.	Market share (%)
1. Merrill Lynch	13,782.9	11.3
2. First Boston/CSFB**	11,111.8	9.1
3. Salomon	10,204	8.4
4. Goldman, Sachs	8,715.3	7.1
5. Morgan Stanley	7,963.1	6.5
6. Shearson Lehman	5,113.6	4.2
7. Deutsche Bank	4,709.4	3.9
8. Nomura	4,348.9	3.6
9. Drexel Burnham	3,621.8	3
10. Daiwa	3,584.3	2.9

* All taxable issues, debt and equity, worldwide
** First Boston/Credit Suisse First Boston
Source: IDD Information Services, New York
Last quarter rankings not available

All issues - domestic*

Firm	Volume $ mils.	Market share (%)
1. Merrill Lynch (4)	11,718.6	17.2
2. Salomon (2)	9,752.7	14.3
3. Goldman, Sachs (1)	8,188.1	12
4. First Boston (3)	7,565.9	11.1
5. Morgan Stanley (5)	7,350.7	10.8
6. Shearson Lehman (6)	4,659.2	6.9
7. Drexel Burnham (7)	3,621.8	5.3
8. Bear, Stearns (9)	2,877.7	4.2
9. Prudential-Bache (10)	2,646.3	3.9
10. Wheat, 1st Securities (11)	2,000	2.9

* All taxable issues, debt and equity, sold in U.S. only
Source: IDD Information Services, New York
Numbers in parentheses show last quarter's rankings

All issues - domestic*

Firm	Volume $ mils.	Market share (%)
1. Merrill Lynch (4)	7,995.9	19.4
2. Salomon (2)	5,240.6	12.7
3. Goldman, Sachs (1)	4,552.3	11
4. Morgan Stanley (5)	4,451.1	10.8
5. First Boston (3)	4,440.6	10.8
6. Shearson Lehman (7)	3,209.3	7.8
7. Drexel Burnham (6)	2,681.8	6.5
8. Wheat, 1st Securities (9)	2,000	4.8
9. Smith Barney (11)	1,774.6	4.3
10. Prudential-Bache (13)	1,140.8	2.8

* All taxable issues, debt and equity, excluding mortgage-related and agency issues sold in U.S. only
Source: IDD Information Services, New York
Numbers in parentheses show last quarter's rankings

All debt issues

Firm	Volume $ mils.	Market share (%)
1. Merrill Lynch (3)	9,764.9	16.8
2. Salomon (1)	9,289	16
3. Goldman, Sachs (2)	7,650.5	13.2
4. Morgan Stanley (5)	7,225.7	12.5
5. First Boston (4)	6,882.9	11.9
6. Drexel Burnham (7)	3,256.4	5.6
7. Shearson Lehman (6)	3,096.1	5.3
8. Bear, Stearns (9)	2,877.7	5
9. Prudential-Bache (10)	1,894	3.3
10. Smith Barney (12)	1,864.3	3.2

Source: IDD Information Services, New York
Numbers in parentheses show last quarter's rankings

Non-investment grade debt

Firm	Volume $ mils.	Market share (%)
1. Drexel Burnham (2)	1,754.8	41.5
2. Morgan Stanley (3)	877	20.8
3. Smith Barney (NA)	498.1	11.8
4. Bear, Stearns (NA)	228.1	5.4
5. Prudential-Bache (NA)	222.1	5.3
6. DLJ (NA)	220	5.2
7. Salomon (NA)	165	3.9
8. Kidder, Peabody (5)	134.3	3.2
9. Merrill Lynch (4)	125	3

Source: IDD Information Services, New York
Numbers in parentheses show last quarter's rankings

Mortgage-related debt

Firm	Volume $ mils.	Market share (%)
1. Salomon (4)	4,512.1	17.6
2. Goldman, Sachs (1)	3,616.2	14.1
3. Merrill Lynch (2)	3,224	12.6
4. First Boston (6)	2,831	11.1
5. Morgan Stanley (13)	2,701.5	10.6
6. Bear, Stearns (5)	2,185.7	8.5
7. Prudential-Bache (9)	1,505.5	5.9
8. Shearson Lehman (3)	1,449.9	5.7
9. Kidder, Peabody (7)	1,083.4	4.2
10. Drexel Burnham (8)	940	3.7

Source: IDD Information Services, New York
Numbers in parentheses show last quarter's rankings

Initial public offerings

Firm	Volume $ mils.	Market share (%)
1. Wheat, 1st Securities (1)	2,000	27.8
2. Merrill Lynch (6)	1,371.6	19.1
3. Shearson Lehman (15)	1,315.1	18.3
4. PaineWebber (32)	1,025.2	14.3
5. Prudential-Bache (7)	680	9.5
6. Drexel Burnham (8)	286.5	4
7. First Boston (5)	150	2.1
8. Goldman, Sachs (13)	127.6	1.8
9. Salomon (NA)	65	0.9
10. Alex. Brown & Sons (2)	31.2	0.4

Source: IDD Information Services, New York
Numbers in parentheses show last quarter's rankings

Common stock

Firm	Volume $ mils.	Market share (%)
1. Wheat, 1st Securities (2)	2,000	25.9
2. Shearson Lehman (14)	1,563.1	20.2
3. Merrill Lynch (8)	1,403.6	18.2
4. PaineWebber (10)	1,033.3	13.4
5. Prudential-Bache (9)	752.3	9.7
6. Drexel Burnham (11)	286.5	3.7
7. First Boston (5)	150	1.9
8. Goldman, Sachs (1)	127.6	1.7
9. Salomon (6)	110.2	1.4
10. Hambrecht & Quist (NA)	53.1	0.7

Source: IDD Information Services, New York
Numbers in parentheses show last quarter's rankings

Preferred stock

Firm	Volume $ mils.	Market share (%)
1. Merrill Lynch (NA)	550	24.3
2. First Boston (NA)	533	23.6
3. Goldman, Sachs (2)	410	18.1
4. Salomon (NA)	353.5	15.6
5. Morgan Stanley (1)	125	5.5
6. Oppenheimer (NA)	100	4.4
7. Drexel Burnham (NA)	79	3.5
8. Smith Barney (NA)	60	2.7
9. DLJ (NA)	25	1.1
10. Interstate Securities (3)	15	0.7

Source: IDD Information Services, New York
Numbers in parentheses show last quarter's rankings

High-yield bond defaults rocket; Texaco role key

By Brad Rudin

Swollen by the bankruptcy of Texaco Inc., the default rate of high-yield bonds almost doubled to 6.7% in 1987 from about 3.4% the previous year, according to a report by Morgan Stanley & Co. Inc., New York.

Excluding the Texaco bankruptcy, the 1987 default rate "was an unexceptional 1.215%," according to the report. Texaco accounted for $6.6 billion of the $8.2 billion of defaulting debt.

Morgan Stanley's report adds more data to a debate sparked by a General Accounting Office hearing last month on high-yield securities. The hearing was in response to congressional concerns about the impact of high-yield securities on corporate takeovers and the risks to federal insurance funds for federally insured deposit institutions that invest in the securities.

Representatives from Standard & Poor's Corp., the U.S. League of Savings Institutions and the Alliance for Capital Access — a group of companies that favors open access to high-yield financing — testified at the hearing. Edwin Altman, a professor at New York University, and other members of the business and academic communities also testified.

Morgan Stanley was not represented at the hearing.

The firm's report, an update of high-yield market research, assesses the risks and rewards associated with high-yield bonds and suggests strategies that would maximize investor returns.

Default loss-rate data present a more accurate picture of the risk associated with high-yield securities than straight default rate data because the numbers reflect the price of the bond after default, according to the Morgan Stanley report.

High-yield investors experienced a default loss rate of slightly more 2.9% in 1987 compared with a cumulative average default loss rate of about 1.5% during the period from 1974 to 1986.

Pointing to the rewards of high-yield bond portfolio management in a bear market, Morgan Stanley noted low-rated bonds outperformed long-term Treasury securities by 712 basis points last year.

Morgan Stanley suggests in its report managers use low-rated securities to diversify the risks of an interest-rate sensitive portfolio because high-yield bonds are less sensitive to interest rate movements than other securities.

At the GAO hearing in Washington, Gail I. Hessol, a managing director at New York-based Standard & Poor's, said the default rate will increase in the next four years. Companies that have low-rated debt because of restructurings have not shown up in default statistics yet, Ms. Hessol noted. "It is only a matter of time before potential problems materialize for some," she said.

Martin S. Fridson, a principal in the credit research group at Morgan Stanley, said in an interview that predictions of substantial increases in the high-yield default rates could not be established. "I really don't know. We're in new territory," he said. ■

Twist added to offering

NEW YORK — Building on its successful introduction of inflation-linked bonds, Morgan Stanley & Co. added a put option to its second offering of the new product.

The deal — popular among pension fund managers — sold quickly despite the novelty of the product, said Richard J. Rogalski, a vice president in the new products group at Morgan Stanley who also is a professor of finance at the Amos Tuck School of Business Administration, Dartmouth College.

Morgan Stanley this month was lead manager for a $100 million offering of inflation-linked bonds, called Real Yield Securities or REALS, for Franklin Savings Association, Ottawa, Kan. The product made its debut in January when Franklin made a $170 million REALS offering.

Because REALS pay a floating rate of interest fixed at a spread above changes in the Consumer Price Index, the instrument assures investors of a positive real rate of return.

The January issue was set at a 300 basis-point spread above the CPI, but the issue priced this month offered investors a 275 basis-point spread because of the annual put option that starts at the end of the third year. The bonds are putable at par.

"Basically, we're still experimenting with it," Mr. Rogalski said.

"We're trying to find out what kinds of things are attractive to investors and the best way to do that is by tinkering with the structure a bit."

The put option is attractive to investors because it puts a floor on the price of the bond after three years, he said.

The issue offered this month matures in 15 years, carries an initial coupon of 6.75% and was priced at par. The interest rate is reset quarterly based on the sum of 2.75% plus the change in the CPI.

The issue is backed by enough collateral to get an AAA rating from Moody's Investors Service and Standard & Poor's Corp.

Investors find inflation-linked bonds attractive because the real rate of return exceeds the performance of non-inflation linked instruments, Mr. Rogalski said.

Morgan Stanley research for the period between 1926 and 1986 shows long-term corporate bonds produced an average real return of 2.2% while long-term government bonds produced an average real return of 1.6%.

The Shearson Lehman Government/Corporate Bond index produced an average annual real return of 1.91% between January 1973 and September 1987, according to the report.

Pension fund managers have been major buyers of REALS both because of the guaranteed real rate of return and because the product hedges liabilities that are positively correlated with average hourly wage compensation, Mr. Rogalski said. "In an asset-liability sense, this is the only game in town to hedge these liabilities."

Property and casualty insurance companies have shown an interest in REALS because the product hedges inflation-driven increases in liability costs.

REALS benefit issuers with businesses whose earnings are correlated with the inflation rate, Mr. Rogalski said. For such an issuer, the higher coupon to be paid on the REALS would be offset by the stronger earnings associated with inflation.

Underwriting

Continued from page 31

market share of 12%.

Merrill Lynch's first-place finish marks the first time the firm has held that honor in at least two decades, according to Securities Data Co., New York.

Merrill Lynch moved up sharply in IDD's common stock category, taking third place in the first quarter after finishing eighth in the last quarter of 1987.

The firm moved from No. 3 in the fourth quarter of 1987 to No. 1 in the underwriting of all debt issues. In this category, Merrill held a 16.8% market share compared with Salomon's 16% share.

But the gap in market share is wider if mortgage-related securities are removed from the debt category, a procedure that produces a more accurate measure of corporate finance activity. Measured in this way, Merrill has a 19.4% market share compared with the 12.7% share held by Salomon, a powerhouse in the mortgage-related underwriting business.

Merrill Lynch has been working to boost its debt underwriting volume for the last three or four years, said Edson V. Mitchell, managing director and head of the debt financing division at the firm. The effort involves closer coordination among the firm's investment bankers, traders and sales people, Mr. Mitchell said.

"Our objective is the long-term profitable penetration of the corporate debt market," he said.

Merrill Lynch's intensified effort resulted in several new clients, Mr. Mitchell said, noting the firm made its debut in the first quarter as a lead manager for Westinghouse Electric Corp., Pittsburgh, and Signal Capital Corp., Hampton, N.H.

Other highlights of first-quarter underwriting activity include:

- First Boston Corp. maintained its top-ranked position in the asset-related sector, with a market share of 40%. Salomon Brothers, however, narrowed First Boston's lead, taking a market share of 34%. In the fourth quarter, First Boston garnered 59% compared with Salomon's 13%.
- Drexel Burnham Lambert Inc. boosted its share of the high-yield debt market to 42% from 34% in the previous quarter. But Drexel held a 50% market share in the first quarter of 1987.
- Wheat, First Securities Inc., Richmond, Va., captured first place in the common stock category because of its $2 billion underwriting of an issue for Massachusetts Financial Services Co., Boston. Wheat, First ranked second in common stock in the last quarter of 1987.
- Salomon recaptured its position as the top-ranked underwriter of mortgage-related debt in the first quarter after sinking to fourth in the last quarter of 1987. Goldman, Sachs, which held the top-ranked slot in the fourth quarter of 1987, fell one notch in the first quarter of this year. ■

"We wanted a shop that produced first quartile international fixed income performance for the past three-year period."

"So who'd you choose?"

"Chase Investors' International Shop...obviously!"

For information about Chase Investors' "Shops Within a Shop" concept, call Joe Martino 212-730-3359.

EBRI

Continued from page 2

surprised by the findings.

"Among our clients, very few took precipitous action as a result of the crash," said Ernest Bianco, director of U.S. consulting and senior vice president, Frank Russell Co., Tacoma, Wash.

Among the company's 40 large clients, one left the stock market completely, another reduced its allocation from 55% to 30%, one took out $300 million just before the crash and two funds bought stock, Mr. Bianco noted. "But our other 30-odd clients did nothing," he said.

Peter Morris, investment director for the Washington-based National Rural Electric Cooperative Association pension fund, also didn't view EBRI's findings as remarkable. "But I don't know that we'll ever really find out (exactly how much left the stock market), because those who sold probably won't tell anyone."

EBRI also found that private trusteed pension funds lost 10.4% of their value during the final quarter of 1987 — the largest quarterly loss in five years.

Net losses were $135 billion — $152 billion in realized and unrealized losses stemming primarily from stock price declines offset by $17.5 billion in dividend payment and interest income.

Of the $152 billion in total losses for the quarter, a $112 billion drop in the value of the equities and a $44.5 billion drop in other types of investments were offset with capital gains of $4.4 billion in fixed income.

EBRI's research found a net gain for the year, since the fourth-quarter losses were offset by three strong prior quarters. For the year, there were total earnings of 6.6%, or $71 billion — $5 billion from capital gains and $66 billion from dividends and interest income. The study also found that despite the fourth-quarter declines, direct stock holdings showed a positive return of 8.7% for the year.

EBRI also found equity assets directly held by pension funds were $405.2 billion as of Dec. 31, about the same as when they began the year, and had grown to $442 billion by April 11.

When funds report their investment results for 1987, Mr. Salisbury said, "it will be as if Oct. 19 never happened."

"It will look as if it was a good year — not a great year but not a bad year — and the blip will not even show."

Total pension assets at the end of the year were $1.118 trillion, still $38 billion ahead of the 1986 year-end level of $1.08 trillion but down from the record high reached at the end of the third quarter of $2.298 trillion.

The decline in stock values shifted the asset mix of private trusteed pension funds, with stock holdings falling to 36% from 40% of the total. Bonds increased to 17% from 14%. The rest of the change was accounted for by a dip in cash to 9% and a slight increase in other assets to 37%.

PBGC says law could hurt

By Nicky Robertshaw

WASHINGTON — In its efforts to toughen minimum funding rules for ailing pension plans last year, Congress might have achieved the opposite effect, officials at the Pension Benefit Guaranty Corp. warn.

Healthy plans, however, might find themselves with a different problem: being assessed an excise tax for exceeding newly tightened maximum funding standards.

The problem in both instances relates to the mandated interest rates used in calculating a plan's liabilities. The minimum funding standard in the Pension Protection Act is 100% of current liability; under the full-funding limit in the Omnibus Budget Reconciliation Act of 1987, an employer loses tax deductions on contributions once plan assets exceed 150% of current liability.

Government officials haven't defined what is included in current liability. While most observers agree it would cover the accumulated benefit obligation, the government also might include such items as early retirement and death and disability benefits.

PBGC officials are concerned the congressionally mandated rate could interfere with the Pension Protection Act's intention of boosting underfunded plans.

"What it does is it reduces the valuation of the liability . . . in essence it weakens the funding standards," said PBGC Executive Director Kathleen P. Utgoff. "I don't think people realized just how many plans would be affected by this change in the law."

Generally, whenever the interest rate used to value the funding level goes up one percentage point, the liability goes down 10 percentage points.

Plans near the full-funding limit have a more immediate concern because they might already be on the hook for excise taxes if their quarterly contributions put them over the limit, according to Dave Guftafson, special assistant to the executive director and manager of the actuarial policy division at the PBGC.

Under the 1987 budget law, the interest rate plans must use to calculate current liability is between 90% and 110% of a four-year average of the interest rate of a 30-year Treasury note. The law, however, gives the Treasury Department authority to adjust the range to between 80% and 90% of the four-year average, and to weigh the four-year average toward the most recent interest rate.

Before the law was enacted, a plan could choose any interest rate that was "reasonable in the aggregate."

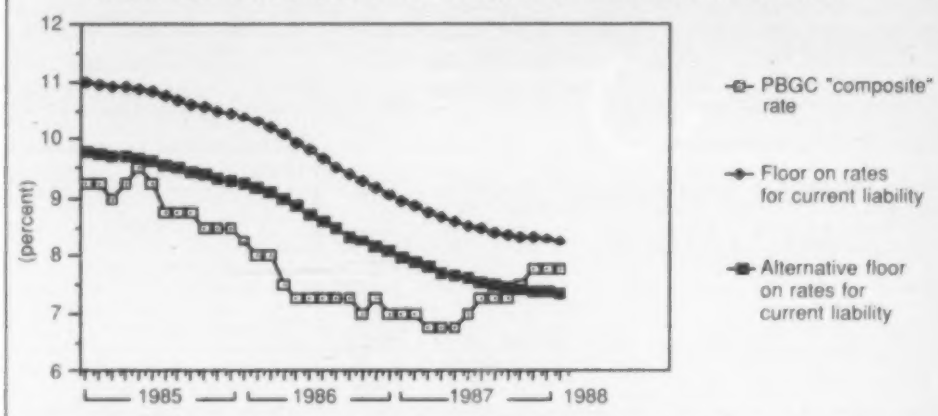
Under the mandated interest rate, "plans are faced not only with this corridor rate that is significantly higher than what they've been using, but it's also volatile," Mr. Guftafson said.

In practice, the new rate appears higher than those used in the past. For example, the average interest rate used to determine funding limits in 1987 was 7.8% for plans with 1,000 or more participants, according to a Wyatt Co. survey of actuarial assumptions and funding, compared with the Internal Revenue Service's rate, calculated as of Jan. 1 under the new law, of 9.12% and a range of 8.25% to 10.05%.

The IRS' first priority will be to issue a notice on how to calculate this interest rate, said James E. Holland, branch chief-pension actuarial branch of the employee plans and exempt organizations area of the IRS, in a speech earlier this year. The agency also is giving priority to defining just what current liability includes.

The problem of the interest rate stems in part from the full-funding provisions being done separately from the Pension Protection Act as a way to address deficit concerns rather than to reform pension funding, Mr. Guftafson said. ■

Interest rates used to calculate current liabilities*



*These rates are intended to represent what might have been in effect if the Omnibus Budget Reconciliation Act of 1987 had been in place for past years. Pending further guidance from the IRS and PBGC, this should be considered a tentative guide

Source: Pension Benefit Guaranty Corp., Washington

SECURE, PROFITABLE INVESTMENTS

JUST WHAT YOU WANT FOR YOUR FUTURE

You want nothing but secure and profitable investments for your future and Frankin Savings can help.

Franklin Savings offers you:

- High rates
- Collateralized CDs with GNMA/FNMA/FHLMC
- Free wire transfers
- Monthly checks
- $99,000 Jumbo CDs

Turn to Franklin Savings for a secure and profitable future. Call us today at 800 247-2492 or in Kansas 800 334-0927.

Franklin
SAVINGS ASSOCIATION
Founded 1889 Member FSLIC

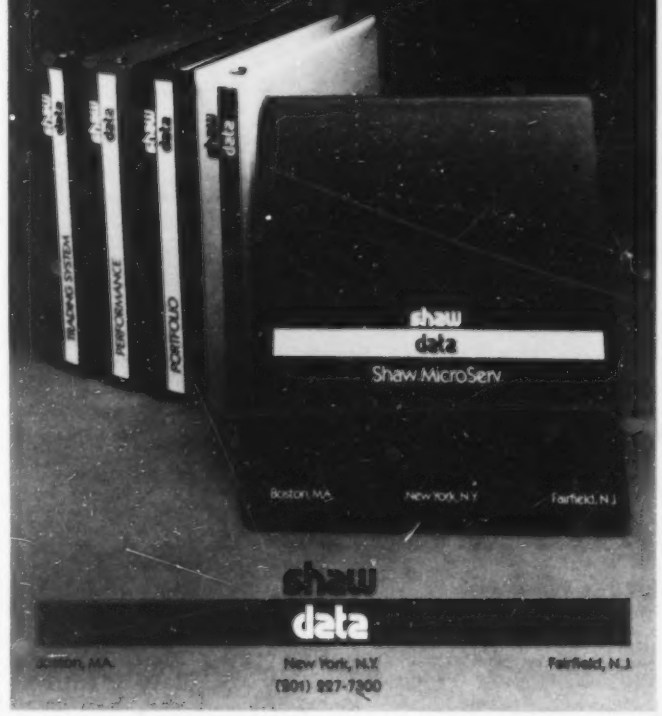
$6.5 billion in assets
Funds Acquisition Division
Ottawa, Kansas

FSLIC Insured to $100,000

The *New* Standard in Micro Based Portfolio Management Systems

For the past 11 years we have offered the premier Online Portfoho Accounting and Management Reporting System...Here we go again.

Shaw MicroServ



shaw data

Boston, MA. New York, N.Y. Fairfield, N.J.
(201) 227-7300

Costs climb

Continued from page 1
period of Oct. 15 to Oct. 21, 31 plan sponsors in its data base assigned 60.7% of their trades to so-called capital brokers (those willing to commit their capital to facilitate trades), 30.9% to research-oriented brokers and 8.4% to brokers that handle soft-dollar payments. During Oct. 15 to Oct. 21, SEI found slight shifts in trades — one percentage point — to capital and research-oriented brokers from soft-dollar brokers.

Data for other periods weren't available.

The study concluded institutions rely less on soft-dollar brokers during demanding periods.

"Execution costs by our measure did go up in the two months after the crash on the order of 1 penny to 1.5 pennies," said Gilbert Beebower, executive vice president, SEI.

According to another SEI study, the median commission paid by 35 pension sponsors for listed stocks fell slightly in the fourth quarter to about 6.2 cents a share from 6.9 cents for the entire year.

And an SEI study of 31 large money managers found commissions averaged 6.3 cents in the last half of 1987. But in November and December alone, the average dropped to 6.1 cents.

"Market impact is much more important than commission cost," noted Theodore R. Aronson, partner at Aronson & Fogler, Philadelphia, which runs $150 million.

At Disciplined Investment Advisors Inc., Evanston, Ill., which manages $500 million, Daniel J. Schweihs, principal, said, "We're having more brokers interested in doing business at 2 to 4 cents a share than were interested before the crash."

He said execution costs are unchanged even in today's less liquid market. He said smaller managers are less affected by the lower liquidity because they can be more nimble than larger managers.

As a result, he expects smaller managers to have better performance than larger ones during the first half.

Goldman, Sachs' Mr. Earle explained principal trading costs are higher because "volatility in the market is less certain. It's very unpredictable; the potential for risk is higher."

But he said Goldman agency transaction rates "have remained the same. I don't think we were at the low end to begin with. We were in the middle or high end."

First Boston's Mr. Mendez added, "A customer has to be more willing to pay more in commissions to get a trade done."

He said he hasn't noticed customers fleeing because trades requiring capital cost more.

Richard M. Crooks Jr., Allen's managing director, said, "There is a reluctance of dealers to commit capital because they all got burnt so badly in October and are shy about committing capital now. You have to pay a higher price to buy or take a lower price to sell." Allen does mainly principal trades, he said.

Aronson & Fogler's Mr. Aronson said the firm saw a rough doubling of bid/ask spreads after the crash. The spread had been a quarter of a point and it went almost as high as a half. Spreads have subsequently narrowed, he added, although they still are above precrash levels.

He said his firm has increased its use of the off-market crossing networks to 20% from less than 5% a year ago. ■

Block trading

	January		February		March	
	1988	1987	1988	1987	1988	1987
Total block trades	62,816	80,483	67,301	67,512	81,037	78,341
Total shares traded in blocks ($ billions)	1.82	2.05	2.07	1.74	2.13	3.56
Percentage of total NYSE volume	52.1	50.8	56	50	52.8	52.9

Source: New York Stock Exchange

Funding limit

Continued from page 1
are not going unnoticed, government officials and plan sponsors are equally concerned about what a solution for these companies might do to other, older plans.

The Internal Revenue Service has said it might increase the limit for companies hardest hit, but this could aggravate problems for more mature pension plans, whose full-funding limit would then be lowered to compensate for any tax dollars lost from the younger plans.

Adjusting the full-funding limits also could interfere with the intentions of the Pension Protection Act's minimum funding standards, enacted to help increase the funding of older, underfunded plans. In effect, pension sponsors now must try to manage their plans within a relatively narrow corridor.

"I think it needs careful study," said Kathleen P. Utgoff, PBGC executive director, who stressed the PBGC did not support the 150% full-funding measure. "It's not clear that there is a real problem, but we are definitely worried about it."

While altering the full-funding limit might help plans with young work forces, any adjustment would have to be balanced with a lower full-funding limit for the mature, problem plans, she said. "So cutting (the mature plans) close to the edge — if it really does cut them close to the edge — could cause us a problem."

The ERISA Industry Committee is polling its members about the effect of the measure and has been asked to share those results with the Treasury Department.

While companies can't go above 150% of current liability without penalty, they must be funded at 100% of current liability to meet the minimum funding standards under the Pension Protection Act. This means from year to year, the funding level must remain within this relatively narrow corridor, something plan sponsors and their advisers fear will be difficult given the volatility both of the interest rate used to value the assets and potential further volatility of the market.

Complicating the picture is a phenomenon that was not anticipated when the Budget Reconciliation Act was being finalized: The interest rates to be used to figure the current liability are higher than what companies have been using in the past few years, and unless modified, could dramatically affect the value of a plan's liabilities (*See story on page 51*).

The full-funding limitation was included in the budget bill as a way to generate $2.4 billion toward helping to trim the deficit, and both the Treasury Department and the tax committees in the House and Senate are seen as unlikely to change this.

"Digital has a real problem, but I don't think other companies are going to be willing to take a hit on their funding ability" to help ease the company's woes, said Mark J. Ugoretz, ERISA Industry Committee executive director. Calling the enactment of the full-funding limit for revenue-raising purposes "an obnoxious reason to manipulate the pension system," Mr. Ugoretz said: "The answer is not the adjustment of the 150% limit but rather its elimination, so we can go back to having some assurances that when retirees retire, the money will be there."

Also critical of the full-funding limit was Christopher Bone, consulting actuary of Actuarial Services Associates, Piscataway, N.J., a division of American Telephone & Telegraph Co.: "The main problem is that you've got a conflict between pension policy and tax policy. From our viewpoint, the full-funding limit was bad pension policy. It's tied to an interest rate that's too volatile, and it does not follow the assets as they go up and down."

The Treasury Department has a deadline of Aug. 15 to complete a study of the effect of the full-funding limit as well as to issue regulations. Those would include specifying how actuaries would figure the interest rate for current liability and defining what current liability encompasses. ■

ERISA exemptions proposed

By Brad Rudin

The Department of Labor might soon lift some restrictions on pension plan investments in several kinds of asset-backed securities.

The proposed exemptions to the Employee Retirement Income Security Act, which could be formally proposed as early as next month, would free some entities involved in the administration of pass-through trusts from what the department regards as restrictions governing the relationship between a corporate pension plan and various parties-in-interest.

The proposal, however, does not incorporate several changes requested by First Boston Corp. and Salomon Brothers Inc., Wall Street's biggest underwriters of asset-backed securities.

For example, securities backed by lease receivables and to unsecured instruments wouldn't be exempt.

In addition, while the proposed exemption applies to the entities that service and operate pass-through trusts, it does not apply to providers of credit support. The Labor Department's concern here is that a conflict of interest might exist if the servicer of the trust is affiliated with the provider of credit support. (An asset pass-through trust is the entity through which pass-through asset-backed securities are sold.)

Diana H. Strickler, a vice president in the asset finance unit at First Boston, said the firm's counsel plans to respond in writing to the Labor Department proposal. Salomon officials did not respond to a request for comment.

Individual exemptions for securities backed by secured consumer receivables, secured commercial receivables, automobile receivables and single-family, multifamily and commercial mortgages soon could be published in the Federal Register. The exemptions also would cover guaranteed governmental mortgage pool certificates.

The Labor Department outlined its proposals in file memorandums regarding separate telephone conversations in late March with the legal representatives of First Boston and Salomon.

Among the specific concerns First Boston and Salomon executives cited in their applications were:

- ERISA violations could result if the sponsor or trustee of an asset pass-through trust has a pre-existing party-in-interest relationship with a pension plan.
- If the sponsor or trustee were considered a fiduciary of the pension plan, sale of the certificates could be barred by ERISA provisions that prohibit a fiduciary from dealing with plan assets in its own interest.
- Prohibited transactions could also occur if the underlying assets of a trust were considered "plan assets" of the pension plan. ■

Where Has The Liquidity Gone?

Liquidity has evaporated as capital and participants have fled the marketplace. Professional Investors have been relying much more on the Jefferies way to get their hard trades done. A broker should be the client's ally rather than adversary. We believe the best trade is when the ultimate buyer and seller set the price. Over the last twenty-five years we have established a unique network to achieve this, including:
200 dedicated professionals
1,600 Institutions
6,000 Corporations
If you trade large blocks and illiquidity has been frustrating, please call Ray Killian, Senior Managing Director, at 617-451-7020. Put the world's strongest trader-sales force on your team.

Service is our Business

JEFFERIES & Company, Inc.
Member SIPC
ATLANTA BOSTON CHICAGO DALLAS NEW YORK LOS ANGELES LONDON
LISTED - OTC - OPTIONS - FUTURES - CONVERTIBLES - M&A

5/3/88

C2710-2

© Entire contents copyright 1988 by Crain Communications Inc. All rights reserved. ©

Investment Age

Best managed companies

Merck & Co. is No. 1 in the minds of money managers.

Managers rate Merck best in U.S.

Merck & Co., General Electric Co., Wal-Mart Stores Inc., McDonald's Corp. and Digital Equipment Corp. are the best-managed U.S. companies, a *Pensions & Investment Age* survey of institutional money managers concludes.

Other companies garnering less, but still significant, recognition are The Dow Chemical Co., Borden Inc., Ford Motor Co., IBM Corp., H.J. Heinz Co., Philip Morris Cos. Inc., Sara Lee Corp., Minnesota Mining and Manufacturing Co., Hewlett-Packard Co., Gannett Co., Sun Microsystems Inc., Abbott Laboratories and Cray Research.

Merck, which took top honors in the *P&I Age* straw poll, also has been acclaimed as a superior company in surveys sponsored by other business publications.

"We're impressed by their research effort and the successful new products they've developed, which provide good earnings visibility," said Hilton Hemphill, president of MSecurities Corp., Dallas, the

Continued on page 48

Buybacks hoist stocks' returns

By Brad Rudin

NEW YORK — Companies that repurchased their stock following buyback announcements delivered returns that handily beat the market, data produced for *Pensions & Investment Age* by Salomon Brothers Inc. show.

But companies that made announcements without buying back the stock posted returns that varied little from the market.

The impact of buyback announcements on stock prices is noteworthy because many companies used this approach in an effort to prop up the price of their shares after last year's stock market plunge.

Among the findings:

- A universe of 100 companies with known progress in completing a buyback program produced an equal-weighted return of 19.03% and a price-weighted return of 23.79%.
- A universe of 100 companies that made no known progress on announced buybacks produced a 15.94% equal-weighted return and a 14.08% price-weighted return between Oct. 19 and April 14. The Standard & Poor's 500 stock index, which is market weighted, delivered a 15.53% return in that same period.
- The companies with the 100 largest buyback announcements in terms of dollars since Oct. 19 — regardless of whether they followed with actual buybacks — produced an equal-weighted return of 14.66% and a price-weighted return of 17.71% through April 14.

Stock buybacks hold the promise of better earnings per share and of higher prices, so investors typically are encouraged.

"If we owned it and they announced a buyback, we'd be more likely to hold on to it than we would before," said Stephen B. Timbers, chief investment officer at Kemper Financial Services Inc., Chicago.

Only about 10% of the stock buyback announcements made in 1987 and the first quarter of 1988 were followed by actual purchases, the data showed. (Because some announcements were made recently, the data could overstate the extent to which companies are ignoring their stock repurchase announcements.)

The Salomon data, and a separate study by Georgeson & Co. Inc., New York, suggest announcements alone did not make these companies perform better than the market.

"Subsequent announcements — as the message strikes home that somebody is speaking with a forked tongue — are going to have a diminishing impact," said Eric T. Miller, chief investment officer at Donaldson, Lufkin & Jenrette Securities Corp., New York.

"You have to put your money where your mouth is to get your bang for the buck," said Jamison G. Graf, vice president and equity manager at One Federal Asset Management Inc., Boston.

The strong showing for companies that actually bought back stock encouraged some money managers.

"I've been a big supporter of buybacks, so I'm pleased as punch that the results support the position that buybacks are favorable," said

Continued on page 55

Announced buyback effect on stock price
10 best performers
(Oct. 19 - April14)

Company	price change %
Firestone Tire	185.59
Sabine	114.77
Oregon Metallurgical	72.97
Cleveland Cliffs	63.27
Hillenbrand Industries	57.8
Quantum Chemical	51.65
Alberto Culver	48.72
Schering Plough	45.99
GAF	45.71
FHP International	42.37

Source: Salomon Brothers Inc.

Walton starts financial firm

By Fred Williams

BENTONVILLE, Ark. — Sam Walton, who became one of the nation's richest men through his chain of Wal-Mart discount department stores, is turning his company's resources to financial services, *Pensions & Investment Age* has learned.

Walton Enterprises Inc. will start a yet-unnamed subsidiary that will focus on public and corporate finance, fixed-income trading and sales and management of separate fixed-income portfolios for banks and employee benefit funds, according to Shack Cashen, chief investment officer of the new firm.

Alice Walton, Mr. Walton's daughter, will be president.

Mr. Cashen said the impetus came from Ms. Walton. Her father "is aware of all this, he knows all the plans and has approved the plans," but won't be directly involved in managing or overseeing the new firm.

Ms. Walton is vice chairman, primary investment officer and a board member of Northwest Arkansas Bankshares, a group of banks owned by Walton Enterprises.

Mr. Cashen joined Walton Enterprises — parent company of Wal-Mart Stores Inc. — seven months ago as chief investment officer of First National Bank Bentonville, whose parent company is Northwest Arkansas Bankshares. He previously worked with Texas billionaire H. Ross Perot.

The move caught financial analysts and investment specialists by surprise; only one analyst contacted had heard of the plan, and then only in general terms.

"This is the first I have heard of it; it may be something he's (Sam Walton) doing on the side . . . It is a different ball game for them all together," said Wayne Hood, retail analyst at Prudential-

Continued on page 54

INSIDE

Overseas numbers game — P. 17

LATE NEWS

Competition for Citicorp narrows

NEW YORK — The bidding contest for Citicorp's money management unit has narrowed to USF&G Corp., Baltimore, and Kemper Financial Services Inc., Chicago, sources said.

The price of the unit, however, has declined to the mid-$90 million range from earlier reports of non-binding bids of $100 million to $110 million, the sources said. The drop reflects that the current bids are binding, market factors and closer looks at the unit's business, they said.

Citicorp officials declined to comment on the sale.

A USF&G spokeswoman confirmed the insurance company is still in the running for Citicorp Investment Management Inc., which manages more than $20 billion in domestic discretionary assets. Kemper officials declined to comment.

Director leaving Boise Cascade

BOISE, Idaho — David R. Norris, director of retirement funds overseeing about $925 million in employee benefit assets at Boise Cascade Corp., is resigning to join SEI Corp.

Mr. Norris, who will hold the newly created position of vice president-plan fiduciary, will join SEI's Chicago office effective May 31. He could not be reached for comment.

Munder becomes independent

BIRMINGHAM, Mich. — The principals of Munder Capital Management Inc. have bought out Security Pacific Investment Group Inc.'s interest in their firm for an undisclosed amount.

Security Pacific, Los Angeles, held a minority share of Munder Capital Management, said Lee P. Munder, president, with the majority held by himself and three associates. Neither Mr. Munder nor a Security Pacific spokeswoman would state the exact amount held by each party.

Mr. Munder and Security Pacific started Munder Capital Management in mid-1985. The firm has grown to nearly $1 billion in assets under management. About 80% is tax-exempt, Mr. Munder said.

He said the principals bought out Security Pacific because they wanted full ownership and control of the firm. Security Pacific realized a significant return on its investment, he added. Neither he nor Security Pacific would state the purchase price or Security Pacific's gain.

Fund launched by TIAA-CREF

NEW YORK — The Teachers Insurance and Annuity Association — College Retirement Equities Fund has approved a group annuity product that would allow participants — for the first time — to move accumulated retirement assets from the fixed-income portion into other investment options, including those outside the TIAA-CREF universe if approved by the sponsoring college or university.

The product, which will be tied in with the previously announced money-market annuity option, is required by the Securities and Exchange Commission as a condition to its granting TIAA-CREF certain exemptions in connection with registering CREF as an investment company under federal law.

Under the proposal, which must be approved by the appropriate regulatory agencies, participants could move 10% of their assets into CREF each year for 10 years, said Peter C. Clapman, senior vice president and association general counsel for the TIAA-CREF.

Once in CREF, assets could be transferred among the equity fund, money-market fund, the group annuity fund - all under the CREF umbrella — or back into the fixed-income fund.

FASB delays draft for 2nd time

STAMFORD, Conn. — The Financial Accounting Standards Board has pushed back the release date for its exposure draft on accounting for post-retirement health benefits until the third quarter of 1988. The draft's release, originally scheduled for the first quarter, previously was postponed until the second quarter.

The FASB expects to issue its final statement on accounting for post retirement medical benefits in 1989, as scheduled, according to Michael Merlob, consultant with William M. Mercer-Meidinger-Hansen Inc., Stamford.

Mr. Merlob said recent personnel changes on the FASB as well as a re-evaluation of cost and funding methods for post retirement benefits lead to the delay.

Philadelphia pension post filled

PHILADELPHIA — John Fuller, deputy director of finance for the city of Philadelphia, has been appointed to the additional post of pension manager for the city's $1.5 billion municipal retirement system. He had been acting pension manager since August.

DEPARTMENTS

Cash management	31	Money movers	50
Financing	37	Opinion	10
International	17	Portfolio management	13
Letters	10	Real estate	23
Market beat	15	Statistically speaking	45

Vol. 16, No. 9 — Pensions & Investment Age (ISSN 0273-5466) is published biweekly with a special edition in May, at 740 Rush St., Chicago, Ill. 60611. Second class postage paid at Chicago, Ill. and at additional mailing offices. Postmaster: Send address changes to Pensions & Investment Age, Circulation Dept. 965 E. Jefferson, Detroit, Mich. 48207. Copyright 1988.

Post-crash tactics

Funds flood allocation managers with calls

By Carol Wiley

Five tactical asset allocation managers have added a total of 35 pension fund clients and handled hundreds of inquiries about the strategy in the six months since Oct. 19.

Pension fund executives are showing increasing interest in active asset allocation strategies as they seek ways to reduce market volatility and cope with the effects of FASB 87.

Those who have signed onto the programs in the past six months also report added value and reduced manager fees with tactical asset allocation.

In addition, the managers said, both sides of the industry now acknowledge what asset allocators have been claiming for some time: 80% to 95% of investment performance is achieved through asset allocation; the remainder, through security selection.

Tactical asset allocation comprises several investment strategies, making short-term switches among asset classes in an attempt to add value in varying market conditions. The shifts are achieved through the use of futures or index funds. Risk measurement is quantitative and disciplined.

Tactical asset allocation "will be the most dominant (investment) style in tax-exempt business in the next three years, no doubt about it," said Bruce Poliquin, vice president and principal of Avatar Associates, New York.

The firm has signed on more than 12 clients in the past six months, including Springs Industries Inc., Fort Mill, S.C.; Levi Strauss & Co., San Francisco; Kroger Co., Cincinnati; Occidental Petroleum Corp., Los Angeles; and National Starch & Chemical Corp., Bridgewater, N.J.

To say business has picked up since the crash "is an understatement," Mr. Poliquin said.

TSA Capital Management, Los Angeles, which manages $3 billion in its tactical asset allocation program, has added six clients since Oct. 19, an average number, according to Roger Clarke, managing director and chief investment officer.

Potential clients, however, make up "a fairly long list," he added. "There's a lot of interest, but people are still very cautious. They're still licking their wounds from Oct. 19."

Bankers Trust Co. — Investment Management Group, New York, has formalized its tactical asset allocation strategy and has one pension client that has invested $50 million. In the two days following the announcement of the product, Vice President Steven A. Lauer said he received six phone calls, compared with "maybe three or four inquiries" all of last year.

He will be making nine presentations on the product in the next two to three weeks.

At a recent conference sponsored by The Northern Trust Co., Chicago, for its master trust clients, there was standing-room only in the session on tactical asset allocation. Northern Trust offers a tactical asset allocation product, designed by Ibbotson Associates, Chicago. Interest in Northern Trust's offering has "quadrupled," and the trust company is negotiating with two potential clients, according to Marvin Waring and Laurence B. Siegel, managing directors of Ibbotson Associates.

Matrix Capital Management, Greenwich, Conn., reports four new clients since the crash — including J.C. Penney Co., New York — bringing total tax-exempt assets in its program to $170 million.

"There has been a tremendous increase in interest" since Oct. 19, said Lynn Edelman, Matrix vice

Continued on page 53

3 resolutions on 'pills' lose; sponsors see stronger vote

By Marcia Parker

Corporations defeated the first of this year's crop of anti-poison pill resolutions sponsored by institutional investors, but the resolutions seem to have generated stronger support than last year.

The resolutions generally asked corporations to seek shareholder approval for poison pills.

The strong showing has given institutional investors a boost at the start of the proxy season. Corporate governance experts agree shareholder support for these early anti-poison pill proposals is significant, although they warn it is too early to draw any conclusions about the rest of the season.

Stockholders at United Technologies Corp., Allied-Signal Inc. and Consolidated Freightways Inc. voted down the first of more than 20 anti-poison pill resolutions on tap for various companies. The State of Wisconsin Investment Board sponsored the resolutions at United Technologies, which was 54% owned by institutions as of March 31, and Allied-Signal, which was 50% owned by institutions as of March 31.

The California Public Employees' Retirement System sponsored the resolution at Consolidated Freightways, 76% institutionally owned March 31.

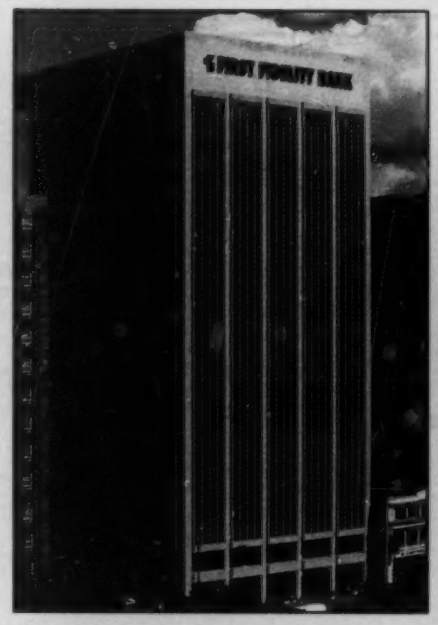
So far, the votes in favor of the anti-poison pill resolution ranged from a low of 32% to a high of 45%, not counting abstentions. Counting abstentions, the vote ranged from 28.8% to 42.4%. Last year, the early votes supporting anti-poison pill resolutions were lower.

"Obviously the votes are holding up and are comparable or better than the early votes on poison pills during last year's proxy season," said Peg O'Hara, who tracks corporate governance issues at the Investor Responsibility Research Center, Washington.

"These are three very strong votes. It shows strong support, although it is too early to tell across the board how all of these resolutions will do during this year's season."

Meantime, the Securities and Exchange Commission derailed efforts by International Paper Co., Dayton-Hudson Corp. and Upjohn Co. to keep anti-poison pill resolutions sponsored by institutional investors off their 1988 proxy statements.

Continued on page 53



Institutional investors are sticking with regional bank stocks such as First Fidelity Bancorporation, Newark, N.J.

Institutions overweight bank stocks

By Curtis Vosti

Despite problems with Texas regional banks and nagging loan troubles in banks across the country, institutional investors remain bullish — if cautiously so — on bank investments.

While institutional weighting of bank stocks has dipped slightly, to 4.4% as of March 31 from 4.7% a year earlier, it still is heavier than the Standard & Poor's 500 stock index's 2.1% weighting as of March 31, ac-

Continued on page 54

FEATURE

Weighing the options

Market-weight indexes open to 1-country domination

By David A. Umstead

The growing dominance of Japanese equities in a typical international stock index fund presents investors with a dilemma of concentrating more than half of their portfolio in one country.

This situation, the result of constructing portfolios based on market-value weight, leads one to look for other designs that would preserve the benefits of such weighting within each national market, while also providing a more diversified distribution of capital across countries.

It is important to understand the reason the market-value weighting is used for indexation. This approach is attractive to index fund managers and shouldn't be abandoned casually. Under it, each security in the portfolio is weighed in proportion to the market value of its total shares outstanding.

Of course, passive investors typically deviate from market weightings in the asset allocation decision. Passive investors, who index all their equities and all their bonds, think nothing of using a mix of the two that is not market weighted. Similarly, investors who index all their domestic equities think nothing of setting their allocation to international equity indexes at a far lower weight than a market weight would dictate.

Even a purely passive investor may want to select a mixture of individual country index funds weighted in some fashion other than market-value weights. The bulk of trading volume in each of the equity markets of the world is still primarily domestic. This suggests the international equity markets are not yet one market. Price movements in each market are still predominantly the result of local events.

Certainly, the market valuation mechanism is far different in West Germany than it is in Japan. For instance, the average price-earnings ratio, using earnings for the 12 months ended March 31, is much lower in Germany, 11.7%, than in Japan, 61.3%.

These idiosyncrasies, which are the very cause of the diversification benefits being sought, are also a reason maintenance of market weightings across countries might not guarantee performing above the average of all international investors.

In place of market-value weight, investors might consider weighting by gross domestic product as a logical alternative. The GDP is an objective measure of the size of each economy; it is not subject to local differences in valuation; and it is more stable over time than market value weights. As a result, it offers a more diversified and uniform distribution of capital around the world.

Table 1 provides a current comparison of GDP- and market capitalization-based allocations for portfolios encompassing the major equity markets of Europe and the Pacific Basin.

The market value-weighted Morgan Stanley Capital International EAFE index shows the weighting favors the two countries with the most highly developed financial markets. Japan and the United Kingdom are given greater weight than the size of their economies would warrant.

On the other hand, a market such as Germany with its enormous economy is underrepresented partly because most of it equity capital has been raised privately.

Smaller, emerging markets such as Spain and Italy are underrepresented partly because of a combination of government ownership and a general lack of sophisticated equity markets.

During the past 18 years, for which data on the EAFE index is readily available, a GDP-weighted version of the index is more uniformly distributed by country and considerably more stable than the market value-weighted index. The market value-weighted portfolio has become more concentrated over time.

Japan began 1970 at 14% of the capitalization-weighted portfolio. By the beginning of 1987, its weight had climbed to more than 50%, and it now exceeds 60%. In the GDP-weighted portfolio, Japan began 1970 at 21%; it currently accounts for just more than 30%.

Another type of international index, one composed of the 50 largest capitalization-weighted non-North American stocks, again illustrates the extreme Japanese concentration from a market value-weighted approach. Of the top 50, only 10 are not Japanese: six stocks in the United Kingdom; two in West Germany; and one each in Italy and the Netherlands.

Contrast this with the top 50

Continued on page 14

David A. Umstead is managing director at Boston International Advisors Inc., Boston.

TABLE 1

Weighting comparison

(As of Dec. 31, 1987)

	Cap index	GDP index	Variance from Cap
Austria	0.2%	1.5%	1.3%
Belgium	0.9	2	1.1
Denmark	0.3	1.4	1.1
France	3.6	11.8	8.2
Germany	4.7	15.8	11.1
Italy	2.6	9.1	6.5
Netherlands	2.2	3	0.8
Norway	0.2	1.1	0.9
Spain	1.5	3.7	2.2
Sweden	1.2	2.2	1
Switzerland	2.8	2.3	−0.5
United Kingdom	14.4	8.7	−5.7
Europe	**34.6**	**62.6**	**28**
Australia	2.1	2.7	0.6
Hong Kong	1.2	0.6	−0.6
Japan	61.4	33.4	−28
Singapore	0.7	0.7	—
Pacific Area	**65.4**	**37.4**	**28**

Source: Morgan Stanley Capital International

TABLE 2

Performance comparison

(total return in U.S. dollar terms)

	Cap index	GDP index	Variance from Cap
1987	25.4%	12.4%	−13 %
1986	69.6	70.9	1.3
1985	56.1	74.5	18.4
1984	7.5	6.7	−0.8
1983	24.3	24.9	0.6
1982	−1.2	−1.2	0
1981	−1.6	−4.4	−2.8
1980	23.2	18.3	−4.9
1979	5.8	8.6	2.8
1978	32.7	37.3	4.6
1977	18.8	12.3	−6.5
1976	3	0	−3
1975	36.5	33.8	−2.7
1974	−22.4	−15.1	7.3
1973	−13.7	−5.1	8.6
1972	39.3	44.4	5.1
1971	29.9	24.8	−5.1
1970	−10.6	−11.3	−0.7
Average	**15.6**	**15.9**	**0.3**

Source: Morgan Stanley Capital International returns, adjusted for GDP weights and withholding tax to U.S. investors.

Study shows topping S&P difficult

NEWPORT BEACH, Calif. — Beating the Standard & Poor's 500 stock index return by at least 400 basis points is an attainable but difficult goal, according to an investment consultant.

In the 10-year period ended Dec. 31, only 11% of equity mutual funds sampled recorded a compound annual return of more than 400 basis points over the S&P 500, said Budge Collins, president of Collins Associates, in a study.

By contrast, 45% of mutual funds beat the S&P index alone in the same period.

Mr. Collins generated the comparisons using the mutual fund data base of CDA Investment Technologies Inc., Silver Spring, Md. For the 10-year period, the data represented 250 mutual funds, $140 billion in assets.

The study shows 1987 was the best year since 1983, with a greater share of mutual funds beating both the S&P itself and the S&P plus 400 goal.

On an annual basis, for years ended Dec. 31, the study found that in:

- 1987, 13% of mutual funds beat the S&P 500 by 400 basis points, while 25% of them beat the S&P 500 alone;
- 1986, 9% and 23%;
- 1985, 11% and 24%;
- 1984, 8% and 18%;
- 1983, 21% and 38%;
- 1982, 45% and 60%;
- 1981, 46% and 62%;
- 1980, 35% and 49%;
- 1979, 68% and 80%; and
- 1978, 49% and 74%.

"For the recent past it's been extremely hard for active managers to beat the S&P 500," said Loretta Morris, a Collins researcher.

For the three-year period ended Dec. 31, 1987, only 3% of the mutual funds beat the S&P 500 by 400 basis points, while 14% beat the S&P 500 alone.

For the five-year period ended Dec. 31, no mutual fund beat the S&P 500 by 400 basis points, while only 11% beat the benchmark index. ■

YOU'RE LOOKING AT ONE OF THE REASONS OTHER ENERGY COMPANIES WISH THEY WERE QUESTAR.

We're in the energy business from top to bottom.

From our headquarters in Salt Lake City, Utah, we engage in oil and gas exploration and production, interstate transmission and storage, and retail distribution of natural gas in one of the country's fastest-growing regions. Our operations in each area of the company make a significant contribution to Questar's bottom line—which results in greater economic stability.

That diversity is what other energy companies are trying to achieve. We've been there for a long time now.

It's paid off.

Our shareholders have received 173 consecutive dividends; we've increased those dividends 15 times in the last 15 years; and our performance compares favorably with other companies in the energy industry.

Write (or call) for more information. And we'll give you more reasons to take a closer look at Questar.

QUESTAR CORPORATION

180 East First South
P.O. Box 11150
Salt Lake City, Utah 84147
Telephone (801) 534-5000